

Audit Report



March 2010

# Performance Audit of the Purchasing and Contracting Department

## The Citywide Open Purchase Order Program is Not the Most Efficient Method of Purchasing Goods and Services

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## THE CITY OF SAN DIEGO

March 30, 2010

Honorable Mayor, City Council, and Audit Committee Members  
City of San Diego, California

Transmitted herewith is an audit report on the City of San Diego Purchasing and Contracting Department. This report is in accordance with City Charter Section 39.2. The Results in Brief is presented on page 1. The Department's response to our audit recommendations can be found as Exhibit C.

If you need any further information please let me know. We would like to thank Purchasing and Contracting Department staff, as well as representatives from other City departments for their assistance and cooperation during this audit. All of their valuable time and efforts spent on providing us information is greatly appreciated. The audit staff responsible for this audit report is Tricia Mendenhall and Kyle Elser.

Respectfully submitted,

Eduardo Luna  
City Auditor

cc: Jay M. Goldstone, Chief Operating Officer  
Wally Hill, Assistance Chief Operating Officer  
Hildred Pepper, Director, Purchasing and Contracting Department  
Jan Goldsmith, City Attorney  
Andrea Tevlin, Independent Budget Analyst  
Stanley Keller, Independent Oversight Monitor

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# RESULTS IN BRIEF

## **THE CURRENT CITYWIDE OPEN PURCHASE ORDER PROGRAM IS NOT THE MOST EFFICIENT METHOD TO PROCURE GOODS AND SERVICES FOR CITY DEPARTMENTS.**

The current citywide open purchase order (PO) program has weaknesses that contribute to the program's inefficient use of City resources for the purpose of procuring goods and services. These weaknesses include a cumbersome manual process, invoices not always paid timely or in compliance with contract terms, the lack of a reconciliation of surcharge amounts received (revenue) versus expenses, and no requirement for departments to encumber<sup>1</sup> funds prior to expending them. These weaknesses result in:

- Wasteful use of City resources due to a duplication of efforts processing purchases;
- Departments potentially make purchases of goods or services without having the required funds;
- Risk of misappropriation of City assets due to control weaknesses surrounding the use of form 2610 to purchase items;
- Monetary losses from discounts not being taken and non-compliance with contract terms; and
- Surplus of funds exceeding \$525,000 that are not being utilized as a result of revenue from citywide open PO surcharge exceeding program expenses.

By incorporating additional controls into departmental open POs and utilizing them or some other method that is more efficient and incorporates effective controls in place of citywide open POs, City Management can ensure more efficient uses of City resources when procuring goods and services.

### **Recommendations:**

1. Incorporate the use of a requisition form similar to a form 2610 in the Departmental Blanket/Open Purchase Order program to reduce the risk of misappropriation.
2. City Management should institute a process and timeline for the elimination of the Citywide Blanket/Open Purchase Order program. Instead, citywide contracts should continue to be established and departments should procure goods and services using the newly revised Departmental Blanket/Open Purchase Order program or some other method that is more efficient and incorporates effective controls.

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<sup>1</sup> To encumber funds means to "set aside" part of a department's budget that has not yet been spent (expenditure) but is obligated.

3. Modify Administrative Regulation 35.15 to adequately reflect the new policies as a result of the actions taken from Recommendations one and two above. Additionally, the Administrative Regulation should include a requirement for departments to document and retain a reconciliation of the requisition forms, similar to the form 2610, on a quarterly basis.
4. City Management should analyze the Stores Revolving fund balance of \$1.4 million to determine how much of this balance represents a surplus. If this analysis results in the determination of a surplus, it should be transferred back to the applicable funds (general, enterprise, etc.) per the annual appropriations ordinance.
5. Central Stores should conduct an annual analysis to ensure that all surcharges (storerooms, mailrooms, etc.) are set at an appropriate level to only recoup the cost of service. This analysis should also include a procedure to transfer any surplus at fiscal year end back to the applicable fund(s).
6. City Management should ensure that all departments are aware of discounts and have appropriate procedures in place so that discounts are taken advantage of for timely payment on City purchases in order to reduce costs.

# INTRODUCTION AND BACKGROUND

The City of San Diego's Purchasing and Contracting Department (Purchasing and Contracting) is responsible for administering the centralized procurement and materials management functions for the City. Purchasing and Contracting staff manage the awarding of contracts for professional and general goods and services needed for City departments to meet their operational goals. The department's responsibilities include performing the daily operational contracting needs for the City, maintaining the warehousing of essential materials, supporting mail room operations, and administering internal service level agreements<sup>2</sup>.

The department is divided into four sections or divisions: Administration, Contracts, Purchasing and Central Stores. Although Purchasing and Contracting is primarily a general fund department, Central Stores is an internal service fund. An internal service fund is a fund that primarily provides benefits or services to other funds or departments on a cost reimbursement basis.

In fiscal year 2006, a Contracting Re-engineering Study was completed as part of the Business Process Re-engineering efforts. The goal of this study was to "review and re-engineer the City of San Diego's procurement processes and procedures; develop recommendations to improve the efficiency and effectiveness; and to improve the quality and accountability of the procurement process".<sup>3</sup> As a result of the study, changes were implemented to the City's procurement process and per a June 22, 2006 Mayoral Fact Sheet, these changes would result in an estimated savings and cost avoidance for fiscal years 2006 and 2007 of approximately \$9 million. These changes included the creation of a new centralized Purchasing and Contracting Department, reduction in personnel costs, and the active monitoring and management of all City contracts. However, the report did not address any recommendations pertaining specifically to Central Stores and the programs it administers.

Per the fiscal year 2010 approved budget document, Central Stores comprises approximately 85 percent of the department's total budgeted expenditures as shown on Table 1.

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<sup>2</sup> An internal service level agreement is an internal contract necessitated when monies are transferred from one City fund to another City fund, as payment for essential services rendered by the provider to the client.

<sup>3</sup> City of San Diego Final Report on Contracting Re-Engineering Study, March 10, 2006



**Table 1: Purchasing and Contracting Fiscal Year 2010 Budgeted Department Expenditures**

	<b>Fiscal Year 2010 Budgeted Expenditures</b>
General Fund, Purchasing and Contracting	\$4,267,264
Central Stores Internal Service Fund (1)	\$23,780,557
Total Departmental Budget	\$28,047,821

(1) \$21,967,515 of Central Stores Internal Service Fund budgeted amount is for inventory purchases for various City departments and storeroom stock.

Source: City of San Diego Fiscal Year 2010 Annual Budget

Central Stores provides a range of service to City departments. This includes administration of the following programs or services: City's Mail Center, Material Safety Data Sheets, Citywide Blanket (Open) Purchase Order<sup>4</sup> Program, Storeroom Operations and Surplus Property / Auction.

#### Citywide Open Purchase Order (PO) Program

A citywide open PO is a purchase order issued to a vendor in order to allow various City departments to acquire goods and services to complete work in progress or to meet emergency needs; it is not intended for purchasing items that can be acquired through City storerooms. For instance, fiscal year 2009 citywide open POs were established for goods and services such as tree maintenance, carpet cleaning, towing service and electrical repairs and materials. Administrative Regulation 35.15 establishes the policy and procedures for the use of the citywide open POs and can be seen at Exhibit B. As of June 1, 2009, there were 185 established citywide open POs available for use by City departments. Estimated sales of goods and services to City departments via the Citywide Open Purchase Order Program are approximately \$15 million annually with approximately 40,000 individual purchases.

Central Stores is responsible for the contract administration and accounts payable function of all citywide open POs. This includes verification that purchases are in compliance with contract terms and condition. During fiscal year 2009, Central Stores had 3.5 employees who performed these tasks. In order to recoup the costs associated with administering this program, departmental billings for purchases made via a citywide open PO include a 5 percent surcharge that is deposited into a revenue account - Stores Revolving Fund.<sup>5</sup> All departments, including general fund and enterprise fund, pay the surcharge. Fiscal Year 2009 annual sales of citywide

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<sup>4</sup> For readability, this report will refer to a citywide blanket purchase order as a citywide open purchase order (PO) and a departmental blanket purchase order as a departmental open purchase order (PO).

<sup>5</sup> This account also includes the surcharge received from Storeroom sales and United States Postal Service (USPS) metered mail operations.

open POs were approximately \$21.4 million. A 5 percent surcharge equates to an annual cost to City departments of approximately \$1 million that is paid to Central Stores for the administration of the citywide open PO program.

#### Citywide Open PO Manual Process

Making City purchases through citywide open PO is a manual process. By working with other Purchasing and Contracting staff, Central Stores establishes a citywide open PO and encumbers the funds from Central Stores' budget. When a department needs to make a purchase from a vendor for a good or service using a citywide open PO that has been established, they do so using a form 2610. The form 2610 is a City form that can be obtained by ordering it at a Central Stores storeroom. The form is only available for use via hard copy and comes with five parts; copy #1 (canary) is retained by the supervisor of the employee who made the purchase, copy #2 (green) is forwarded to Central Stores, copy #3 (blue) is provided to the departmental purchasing liaison for retention in file, and copies #4 and #5 (pink and white) are left with the vendor at time of purchase. A blank form 2610 can be seen at Exhibit A.

Once a citywide open PO purchase is complete and has been certified by the appropriate Department Supervisor, a copy of the completed 2610 form (with packing slip if item was delivered) is forwarded to Central Stores. Central Stores also receives the invoice from the vendor when payment for a purchase is due. Central Stores ensures the form 2610 matches the invoice, checks for compliance with contract/PO terms and conditions, and then processes the invoice for payment. Upon payment of the invoice from the City's accounts payable system, Central Stores "bills" the department the amount of the invoice and the 5 percent surcharge based on the accounting information provided to them by the department on the form 2610.

## **AUDIT OBJECTIVES, SCOPE AND METHODOLOGY**

The City Auditor's fiscal year 2009 and 2010 Audit Work Plans included a performance audit of the Purchasing and Contracting Department. The objective of this audit was to determine if Purchasing and Contracting has sound procurement procedures in place, and to evaluate the efficiency and effectiveness of the department's procedures. A Business Process review was conducted for the City's procurement and contracting practices and in fiscal year 2006 the Final Report on Contracting Re-Engineering Study was issued. The purpose of the study was to review and re-engineer the City's procurement processes and procedures; develop recommendations to improve the efficiency and effectiveness; and to improve the quality and accountability of the procurement process. As a result, many of the recommendations made by the report were implemented and cost savings and cost avoidance for fiscal year 2006 and 2007 were estimated to be \$2.3 million and \$6.7 million, respectively. Therefore, we narrowed the objective of our performance audit of the Purchasing and Contracting Department to determine the efficiency and effectiveness of the citywide open purchase order program; specifically for fiscal year 2009.

This is the third and final report issued for the performance audit of the Purchasing and Contracting Department. Previous audit reports for this performance audit were issued in December 2008 and December 2009 and include the 2007 Wildfire Debris Removal Project report and the City Charter Requirements for Unclaimed Funds report, respectively.

To accomplish our objectives related to Purchasing and Contracting, we performed the following audit procedures for this report:

- Reviewed City regulations pertaining to citywide blanket purchase orders;
- Interviewed staff of City departments that regularly utilize citywide blanket purchase orders;
- Interviewed Purchasing and Contracting and Central Stores staff;
- Surveyed various other municipalities regarding purchasing programs utilized;
- Analyzed fiscal year 2009 citywide open purchase order expenses;
- Analyzed fiscal year 2009 costs to administer the citywide open purchase order program; and
- Calculated approximate surcharge received by Central Stores in fiscal year 2009 based on total citywide open purchase order expenses.

We evaluated internal controls related to the audit objectives. Our conclusions on the effectiveness of these controls are detailed within the following audit results.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# AUDIT RESULTS

## **THE CURRENT CITYWIDE OPEN PURCHASE ORDER PROGRAM IS NOT THE MOST EFFICIENT METHOD TO PROCURE GOODS AND SERVICES FOR CITY DEPARTMENTS.**

The current citywide open purchase order (PO) program has weaknesses that contribute to the program's inefficient use of City resources for the purpose of procuring goods and services. These weaknesses include a cumbersome manual process, invoices not always paid timely or in compliance with contract terms, the lack of a reconciliation of surcharge amounts received (revenue) versus expenses, and no requirement for departments to encumber<sup>6</sup> funds prior to expending them. These weaknesses result in:

- Wasteful use of City resources due to a duplication of efforts processing purchases;
- Departments potentially make purchases of goods or services without having the required funds;
- Risk of misappropriation of City assets due to control weaknesses surrounding the use of form 2610 to purchase items;
- Monetary losses from discounts not being taken and non-compliance with contract terms; and
- Surplus of funds exceeding \$525,000 that are not being utilized as a result of revenue from citywide open PO surcharge exceeding program expenses.

By incorporating additional controls into departmental open POs and utilizing them or some other method that is more efficient and incorporates effective controls in place of citywide open POs, City Management can ensure more efficient uses of City resources when procuring goods and services.

### Wasteful Use of City Staff Resources

The use of citywide open POs causes a duplication of efforts resulting in an inefficient and wasteful use of City staff resources. Invoices for purchases made on citywide open POs are being processed twice; once by Central Stores when payment to the vendor is made, and again when Central Stores bills the using department for the cost of the item plus their 5 percent surcharge. Additionally, due to the volume of purchases made on citywide open POs, approximately 40,000 individual purchases per year, this process results in a large amount of paperwork that must be reviewed by both the using departments and by Central Stores.

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<sup>6</sup> To encumber funds means to "set aside" part of a department's budget that has not yet been spent (expenditure) but is obligated.

### Potential for Purchases Made Without Funds Available

The citywide open PO process does not require departments who are making purchases to establish encumbrances; the setting aside of budgetary dollars for a future purchase. Encumbering funds is a control that helps to ensure that departments have funds available for payment of specified expenses. When funds are not encumbered within a department's budget prior to purchasing goods and services, the department runs the risk that funds may not be available when the payments for goods or services are due. Without the establishment of an encumbrance, departments need to ensure appropriate tracking of all citywide open PO purchases and associated surcharges.

The implementation of SAP<sup>7</sup> has not modified this process. Additionally, as of November 30, 2009, all purchases (and related surcharges) made on citywide open POs since the implementation of SAP on July 1, 2009 had not yet been billed to the using departments; the expense has only been incurred by Central Stores. Although a process has since been implemented for Central Stores to bill using departments for citywide open PO purchases, the delay in implementing this process increased the risk that City department may exceed their fiscal year 2010 budget. Due to the volume of transactions and the paperwork involved, it was not practical for us to analyze the monetary impact of these expenses.

### Citywide Open PO Control Weaknesses Poses a Risk of Misappropriation

The internal controls over the issuance and the use of the form 2610 during the citywide open PO process are also lacking, which increases the risk of misappropriation of City assets. As noted by both the former Auditor & Comptroller in the January 1, 2006 Annual Report on Internal Controls and by KPMG, LLP in the fiscal year 2003 Independent Auditor's Report<sup>8</sup> issued in March 2007, a form 2610 is used in the same capacity as a blank check. Once a citywide open PO has been issued, City employees in possession of a form 2610 could obtain goods and services directly from a vendor location. Both reports noted a lack of controls and monitoring over the issuance of form 2610.

The February 21, 2007 Kroll Remediation Status Report presented to the City Council noted that Central Stores Department Instruction Number DA-1.01 was issued to ensure the proper and accurate issuance and handling of City's financial requisition forms (including form 2610). However, this policy does not require the City department who purchase and utilize the form 2610 to have adequate controls over the form 2610, nor does it require City departments or Central Stores to perform a reconciliation of these forms to make sure they are all accounted for.

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<sup>7</sup> SAP implementation for logistics (purchasing and contracting) implemented July 1, 2009 under project name OneSD.

<sup>8</sup> Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.

When Central Stores issues/“sells” form 2610s, the number of the forms sold and the document number sequence of the forms is recorded, but no reconciliation is performed.

There is also an Administrative Regulation (AR) 35.15 that requires these forms to be secured in a locked cabinet or area with limited access by the City department who purchased the forms. However, this AR also does not require the department to perform any sort of reconciliation of the 2610 forms issued. The lack of accountability for these forms can lead to misappropriation of City assets.

#### Monetary Loss from Lost Discounts and Non-compliance with Contract Terms

The citywide open PO process has a high rate of lost discounts resulting in a monetary loss to the City. Some vendors offer the City discount terms for invoices paid within a certain time period. During fiscal year 2009, \$52,780 in discounts was offered to the City. However, \$35,225 of these discounts was not taken by the City because invoices were not paid within the discount period. Our review of the lost discounts revealed that \$30,720 or 87 percent of the discounts not taken were attributable to citywide open PO purchases.

The current citywide open PO process makes it difficult for discounts to be taken advantage of by the City. As invoices and form 2610s are received by Central Stores, they are filed in the citywide open PO file. Each file is processed approximately once a month. If an invoice for a certain citywide open PO is received the day after that citywide open PO file was processed, the invoice will not be processed until the following month. Central Stores staff stated they try to process invoices that offer discount terms more than once a month. However, as stated above, there is a high percentage of lost discounts on citywide open PO purchases.

#### Non-Contract Compliance with Contract Terms

Central Stores is responsible for the contract administration of all citywide open POs. Per AR 35.15, it is the responsibility of Central Stores staff to verify that the invoices are in compliance with contract terms prior to processing payment. We randomly selected a sample of only three citywide open POs to review for contract compliance due to the volume of invoices processed for each one. We noted the following for the three citywide open POs tested:

- A citywide open PO was issued to a vendor for carpet cleaning services. The terms of the PO includes specific per square foot pricing based on the size of the area to be cleaned. Of the six invoices reviewed, we noted two invoices that were not paid in accordance with the PO pricing resulting in a total overpayment to the vendor of \$221. The Purchasing and Contracting Department was made aware of this overpayment to recoup it.

- A citywide open PO was issued to a vendor for miscellaneous equipment and tools. This PO states that no individual item with a unit price in excess of \$750 plus sales tax is to be purchased on this PO. It also states that the total purchase amount is not to exceed \$2,000 per order plus sales tax. Of 61 invoices reviewed, we noted two invoices that included the purchase of items with a unit price greater than \$750. Additionally, one of these invoices had a total that exceeded \$2,000. When PO terms are not adhered to, the City runs the risk of purchasing items at prices that may not be the best value.
- A citywide open PO was issued to a vendor for carpet cleaning services. The PO includes specific per square foot pricing. However, our review of one invoice revealed that it included only the description of “Carpet Cleaning” with a total price. A condition of all City POs is that invoices shall reference an item number, description of supplies or services, sizes, unit of measure, quantity, unit price, and extended totals. Without detailed information included on invoices, a verification that invoice pricing is in compliance with contract/PO pricing cannot be done.

City staff’s review of invoices for compliance with all contract and PO terms and conditions needs to be completed prior to invoices being processed for payment. This review can help to reduce the risk that the City is overpaying invoices. This type of review should be conducted by the Central Stores staff for citywide open PO purchases.

#### Citywide Open PO Surcharge Exceeds Program Expenses Resulting in a Surplus

Central Stores is an internal service fund, which primarily provides benefits or services to other funds or departments on a cost reimbursement basis. For the citywide open PO program, Central Stores recoups the cost of the service they provide by charging using departments a 5 percent surcharge in addition to the amount of the invoice purchase price. The funds in the revenue account in which all Central Stores surcharges are deposited are used to cover the expenses associated with the programs Central Stores administers including the citywide open PO program, storerooms, mailrooms, etc. A surplus of funds has accumulated in the Central Stores internal service fund in part because the revenue from the 5 percent surcharge has exceeded the actual administrative costs for the citywide open PO program. As of June 30, 2009, this fund had a balance of approximately \$1.4 million<sup>9</sup>, and any surplus within this balance is not being transferred back to the general fund or enterprise funds.

A review of Central Stores expenses compared to the surcharge collected for fiscal years 2007 through 2009 revealed that over this period, surcharges collected actually exceeded expenses by a total surplus of \$527,535 as shown in Table 2.

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<sup>9</sup> This amount is the revised budget less actual expenses.



**Table 2: Total Central Stores Surplus (Surcharge in Excess of Expenses) for Fiscal Years 2007 to 2009**

	Fiscal Year 2007	Fiscal Year 2008	Fiscal Year 2009	Total
<b>Total Surcharge Received</b>	\$2,329,073	\$2,279,016	\$2,311,295	\$6,919,384
<b>Total Expenses (I)</b>	\$2,234,109	\$2,224,358	\$1,933,382	\$6,391,849
<b>Surplus/(Deficit)</b>	\$94,964	\$54,658	\$377,913	\$527,535

Source: Office of the City Comptroller's Simpler Financials data

*(1) This does not include storeroom stock inventory purchases or any Comptroller year end adjustments made for estimated accounts payable accruals.*

Although we were not able to determine what portion of the total \$527,535 surplus<sup>10</sup> was directly attributable to the citywide open PO program for fiscal years 2007 and 2008, we were able to estimate the surplus amount attributable to the citywide open PO program for fiscal year 2009 was approximately \$350,000<sup>11</sup> or 93 percent of the total Central Stores fiscal year 2009 surplus of \$377,913.

We questioned Comptroller staff to determine if this surplus could be transferred to the general fund. Comptroller staff advised that although the Appropriation Ordinance does allow for the distribution of surplus retained earning from internal service funds; this surplus would have to be distributed back to the contributing funds – not just the general fund. In fiscal year 2006, the Central Stores decreased the surcharge for Storeroom services and citywide open PO administration from 10 percent to the current surcharge of 5 percent; however, there has not been a formal annual study conducted by the City since 2006 to determine the appropriateness of the surcharge rate. An annual analysis of this fund should be performed to ensure that any Central Stores surcharge is set at a percentage rate that will not accumulate an additional surplus of funds, and any existing surplus should be returned to the general fund and enterprise funds.

<sup>10</sup> Citywide open PO surcharge is deposited into the same revenue account as the surcharge received from storeroom sales and USPS metered mail and is not tracked separately.

<sup>11</sup> The fiscal year 2009 surplus amount attributable to the citywide open PO program was calculated to be approximately \$350,000 by multiplying the 2009 citywide open PO invoices by the 5 percent surcharge for a surcharge amount of approximately \$634,000, less the cost for Central Stores to administer the citywide open PO program totaling approximately \$284,000 based on information received from Central Stores staff.

## Survey of Other Municipalities for Best Practices

While reviewing the citywide open PO program, we reviewed other municipalities<sup>12</sup> and how they administer similar programs for best practices. Based on the information received, we concluded that the City's citywide open PO program is not a best practices method of procuring goods and services. We found that other municipalities establish a master countywide or citywide type purchase order (PO) for a set funding limit and time period. However, no funds are encumbered at the time the master POs are set up. Instead, when a department or division needs to purchase goods or services from that PO, a release or department PO is issued from the master PO, and the funds are then encumbered at the department or division level. This process typically does not include the use of a surcharge.

A departmental PO is used at the City in a similar capacity as the process described above. These are POs that are established by a City department for the purchase of goods and services needed from a particular vendor, and the funds are encumbered by the department at the time the PO is established. Purchasing and Contracting staff routinely establish authorized contract pricing which all City departments can utilize for purchases made on departmental open POs. Departments do not pay a surcharge for establishing and utilizing a departmental open PO and the department who establishes the PO is the same department who administers the PO (makes purchases of goods and services from the PO and processes payments for the PO) thereby eliminating any duplication of efforts.

According to Purchasing and Contracting staff, for departmental open POs, citywide contracts are established for purchases of "as needed" goods and services (such as office furniture), whereas a citywide open PO is established for reoccurring purchases of specific goods and services.

Continuing to use citywide open POs as opposed to departmental open POs increases the risk to the City that goods and services are not being purchased in the most efficient manner. However, the Assistant Chief Operating Officer commented that because the departmental open POs do not require for staff to utilize a requisition form similar to a form 2610, a risk of misappropriation exists. Although we did not test departmental open POs, in our opinion, incorporating the use of a requisition form similar to a form 2610 in the departmental open PO program would help to reduce this risk, while still incorporating the controls that do not exist in the citywide open PO program.

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<sup>12</sup> Municipalities contacted and responses received: County and City of San Francisco, City of San Antonio, County and City of Denver, Salt Lake City, County of San Diego, City of Austin, and City of San Jose.

## CONCLUSION

There are many different methods of procuring goods and services for use by City employees. These methods should help to ensure the City is getting the best value and that the risk of misappropriation is mitigated by ensuring appropriate controls are in place. The citywide open purchase order program is not the most efficient method of purchasing goods and services. It has weaknesses that result in wasteful use of City resources, high possibility of City departments making purchases without having appropriate budget available, and a risk of misappropriation of City assets. By modifying the current departmental open PO program and utilizing it in place of citywide open POs, City management can ensure more efficient uses of City resources when procuring goods and services.

### Recommendations:

1. Incorporate the use of a requisition form similar to a form 2610 in the Departmental Blanket/Open Purchase Order program to reduce the risk of misappropriation.
2. City Management should institute a process and timeline for the elimination of the Citywide Blanket/Open Purchase Order program. Instead, citywide contracts should continue to be established and departments should procure goods and services using the newly revised Departmental Blanket/Open Purchase Order program or some other method that is more efficient and incorporates effective controls.
3. Modify Administrative Regulation 35.15 to adequately reflect the new policies as a result of the actions taken from Recommendations one and two above. Additionally, the Administrative Regulation should include a requirement for departments to document and retain a reconciliation of the requisition forms, similar to the form 2610, on a quarterly basis.
4. In the interim, City Management should analyze the Stores Revolving fund balance of \$1.4 million to determine how much of this balance represents a surplus. If this analysis results in the determination of a surplus, it should be transferred back to the applicable funds (general, enterprise, etc.) per the annual appropriations ordinance.
5. Central Stores should conduct an annual analysis to ensure that all surcharges (storerooms, mailrooms, etc.) are set at an appropriate level to only recoup the cost of service. This analysis should also include a procedure to transfer any surplus at fiscal year end back to the applicable fund(s).

6. City Management should ensure that all departments are aware of discounts and have appropriate procedures in place so that discounts are taken advantage of for timely payment on City purchases in order to reduce costs.

CITY OF SAN DIEGO  
GENERAL SERVICES DEPARTMENT / CENTRAL STORES

## Blanket/Open Purchase Requisition and Invoice

**CITY EMPLOYEE INSTRUCTIONS:** This form is to be used only for NON CITY STOREROOM items. Items ordered are to be from vendor stock and subject to P.O. conditions and dollar limits. Refer to department purchasing liaison for specific order information. Use your petty cash fund for purchases under \$10. **Copy #2 (green) must be submitted to Central Stores (MS 82B) within 5 days of purchase, or invoice may be returned to department for payment.**

1. Complete this form, including quantity and item description.
2. Have vendor enter stock/part no., quantity delivered, unit price and price extension.
3. Retain originator copy 1, give copies 4 and 5 to vendor/supplier.
4. Return copies 2 and 3 to your department.

SOLD TO: (DEPT./DIV.)	DATE:	PO NUMBER:				
ENTER VENDOR/SUPPLIER NAME AND ADDRESS BELOW:		INV. NUMBER:				
<div style="border: 1px solid black; width: 100%; height: 100%; position: relative;"> <div style="position: absolute; top: 0; left: 0; width: 100%; height: 100%; border: 1px solid black;"></div> </div>		<table style="width: 100%; border: none;"> <tr> <td style="text-align: center; border: none;">ISSUE</td> <td style="text-align: center; border: none;">CREDIT</td> </tr> <tr> <td style="text-align: center; border: none;"><input type="checkbox"/></td> <td style="text-align: center; border: none;"><input type="checkbox"/></td> </tr> </table>	ISSUE	CREDIT	<input type="checkbox"/>	<input type="checkbox"/>
ISSUE	CREDIT					
<input type="checkbox"/>	<input type="checkbox"/>					

**Please supply the following item(s) / material:**

ITEM NO.	ORDER QUANTITY	ITEM DESCRIPTION	VENDOR STOCK/PART NO.	QUANTITY DELIVERED	UNIT PRICE	PRICE EXTENSION
1.						
2.						
3.						
4.						
5.						
6.						
7.						
8.						
					SUB TOTAL	
					SALES TAX	
					TOTAL	\$
RECEIVED BY: (PRINT)			SIGNATURE:		DATE:	

### INSTRUCTIONS TO VENDOR

1. Purchase order limits must be closely adhered to with regard to individual purchase amount, commodities covered and total dollar amount of P.O.
2. All persons authorized to receive merchandise will have City supplied identification cards. Please ask to see this card each time a sale is made.
3. Do **NOT** issue merchandise unless a legible printed name, signature, identification number and date appears on this form.
4. Ensure accuracy of item description and stock/part number. Include both unit price and price extension.

***FAILURE TO ABIDE BY THESE INSTRUCTIONS MAY RESULT IN REFUSED PAYMENTS***



CITY OF SAN DIEGO

ADMINISTRATIVE REGULATION

SUBJECT	Number	Issue	Page
	35.15	2	1 of 8
CITYWIDE BLANKET PURCHASE ORDER (CWBPO)	Effective Date June 20, 2005		

1. PURPOSE

- 1.1 The purpose of this administrative regulation is to establish policy and procedures for the use of citywide blanket purchase orders (CWBPO).

2. SCOPE

- 2.1 This regulation applies to all City of San Diego departments and employees who make purchases under citywide blanket purchase orders. The procedures under Section 5 apply only to citywide blanket purchase orders and do not apply to departmental blanket purchase orders.

3. DEFINITIONS

3.1 Citywide Blanket Purchase Orders (CWBPO)

A citywide blanket purchase order is a purchase order issued to a vendor in order to allow various City departments to acquire from the vendor shelf stock items and services required to complete work in progress or to meet emergency needs. Items covered under citywide blanket purchase orders are not normally available in Central Stores stock.

3.2 Departmental Blanket Purchase Orders (DBPO)

A departmental blanket purchase order is a purchase order issued to vendor to allow the acquisition of items and services necessary to meet the particular needs of a specific department or division or to enable completion of work in progress. Only non-Central Stores stock items are allowable for purchase under departmental blanket purchase orders.

4. POLICY

- 4.1 Citywide and department blanket purchase orders were developed to assist departments in acquiring materials and services needed for emergency situations. Their use is justified only when other methods of acquisition are not feasible. Other methods to use first are petty cash or a Purchase Requisition Form PA-2159.

(Supersedes Administration Regulation 35.15, Issue 1, effective December 12, 1988)

Authorized

(signed by John Torell)

Auditor and Comptroller

(signed by P. Lamont Ewell)

City Manager

CITY OF SAN DIEGO  
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- 4.2 The citywide blanket purchase order is used basically for the small order or to expedite acquisition of urgently needed materials and services for all departments. THESE PURCHASE ORDERS ARE ORIGINATED BY THE PURCHASING DEPARTMENT ONLY.
- 4.3 CITYWIDE BLANKET PURCHASE ORDERS ARE INVOICED TO CENTRAL STORES ONLY by the vendors. Central Stores bills the using departments through the use of a Blanket Purchase Order Form PA-2610 which is serially numbered and accountable. This form is to be used for citywide blanket purchase orders only and should not be used for departmental blanket purchase orders.
- 4.4 The departmental blanket purchase order (DBPO) is USED EXCLUSIVELY BY THE DEPARTMENT ON WHOSE BEHALF THE PURCHASE ORDER IS ISSUED.
- 4.5 DEPARTMENTAL BLANKET PURCHASE ORDERS ARE INVOICED ONLY TO THE SPECIFIC DEPARTMENT NAMED. Departments may request a departmental blanket purchase order by submitting a Purchase Requisition Form PA-2159 to the Purchasing Department.
- 4.6 The following items are generally NOT TO BE PURCHASED on blanket purchase orders:
- a. Equipment outlay items.
  - b. Any item beyond immediate needs.
  - c. Any item not in local vendor stock. Delivery is generally not allowed.
  - d. Any item carried in Central Stores stock. If an out of stock condition occurs at time of urgent need, stock will be ordered. Call Central Stores.
  - e. Small hand tools.
  - f. Any item of bottle gases in vendor's cylinders.
  - g. Any item exceeding the citywide blanket purchase order limits as stated in the body of the purchase order.
  - h. Items totaling less than \$25.00 should not normally be purchased on a citywide blanket purchase order. Use your departmental petty cash fund for small dollar purchases when possible.
- 4.7 All items must be approved by an authorized supervisor within the department picking up or receiving the materials.

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- 4.8 The Citywide Blanket Purchase Order Form PA-2610 must be forwarded to Central Stores within twenty-four (24) hours of obtaining materials or services. Failure to forward the citywide blanket purchase order form within twenty-five (25) days of pickup may cause the City department making the purchase to lose the citywide blanket purchase order privilege.

5. PROCEDURE

<u>Responsibility</u>	<u>Action</u>
Purchasing Department	<p>5.1 Originates all citywide blank purchase orders.</p> <p>a. Buyer, in consultation with requesting department(s) and Central Stores, determines need. Annual purchase orders are preferred with quarterly and semi-annual purchase orders based on certain circumstances.</p> <p>b. Buyer originates purchase requisition.</p> <p>c. Purchase Order Writer Clerk enters requisition into the Purchase Order Writer System.</p>
Auditor & Comptroller	<p>5.2 Approves or disapproves purchase requisition via terminal. If approved, a purchase order is printed and forwarded to Purchasing. If not approved, a status report is printed and forwarded to Purchasing.</p>
Requesting Department	<p>5.3 Orders a supply of Blanket/Open Purchase Requisition(s) and Invoice forms (PA-2610) from Central Stores.</p>
Departmental Purchasing Liaison	<p>5.4 Secures PA-2610 forms in a locked cabinet or area, with access limited to Departmental Purchasing Liaison and that position's supervisor.</p> <p>5.5 Issues forms to supervisors who normally use blanket purchase orders and maintains a log of form numbers issued to each supervisor.</p>



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<u>Responsibility</u>		<u>Action</u>
Department Supervisor	5.6	Maintains a log of each PA-2610 form issued, including form number, name of employee receiving form and date.
Department Supervisor	5.7	When a citywide blanket purchase order purchase is required, completes the following fields on Form PA-2160: <ul style="list-style-type: none"> <li>a. Sold to: (Dept./Div.)</li> <li>b. Date</li> <li>c. PO Number (from current list)</li> <li>d. Vendor's name and address</li> <li>e. Order quantity</li> <li>f. Item description</li> </ul>
Receiving Employee	5.8	Takes Form PA-2160 to vendor. Presents employee ID card and has vendor complete the following fields: <ul style="list-style-type: none"> <li>a. Vendor stock/part number</li> <li>b. Quantity delivered</li> <li>c. Unit price</li> <li>d. Price extension</li> <li>e. Subtotal</li> <li>f. Sales tax</li> <li>g. Total</li> </ul>
	5.9	After receiving goods from vendor, verifies all vendor information is complete, prints name in "Received by" block, signs, enters last four digits of social security number and enters date.
Receiving Employee (cont'd)	5.10	Separates copies #4 and #5 (pink and white) and leaves them with the vendor.

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<u>Responsibility</u>		<u>Action</u>
Receiving Employee (cont'd)	5.11	Returns remaining copies #1, #2 and #3 (canary, green and blue) to department supervisor along with vendor packing slip (if one is provided).
Department Supervisor	5.12	Detaches and retains copy #1 (canary).
	5.13	Completes certification block in upper right hand corner of copy #2 (green).
	5.14	RETURNS COPIES #2 AND #3 (GREEN AND BLUE) TO DEPARTMENTAL PURCHASING LIAISON PRIOR TO CLOSE OF BUSINESS ON DAY OF PURCHASE.
Departmental Purchasing Liaison	5.15	Verifies that Form PA-2610 is completely filled out. Verifies employee's name, signature and identification number as well as supervisor's name and signature.
	5.16	Enters accounting information at bottom of copy #2 (green). All columns, from left to right, through Organizational Level are REQUIRED. The remaining columns are optional.
	5.17	Detaches and sends copy #2 (green) to Central Stores along with copy of packing slip, invoice, etc...
	5.18	Retains the #3 copy (blue) for files.
Purchasing Department	5.19	Central Stores performs the following tasks:
	a.	Files pending purchase orders by vendor.
	b.	Files and time stamps pending invoices by vendor.
	c.	Files pending Form PA-2610.
	d.	Matches invoices and delivery receipts to purchase Form PA-2610.

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Responsibility

Purchasing Dept (cont'd)

Action

- e. Verifies pricing of contract item and extensions. Verifies item and dollar authorization. If not correct, gets Buyer to designate options available and approve deviations or returns to originator for purchase requisition.
- f. Batches matched detail. Insures stores blanket requisitions are cross referenced to invoice and purchase order. Runs tape, balances, creates receiving report and sends to Auditor along with notices of late receipt of invoices when needed and indicating late codes.
- g. Reviews vendor folder and match invoices to citywide blanket purchase order Form PA-2610. If form has not been received for an aging invoice, then:
  - 1. Notifies the department within fifteen (15) days of receipt of invoice and logs action.
  - 2. Ten (10) days later, contacts department for action.
  - 3. If no response from department, turns in a log report each time a folder is matched.
  - 4. Notifies department supervisor and reports to Assistant Purchasing Agent.
  - 5. Assistant Purchasing Agent will notify Department Director of not complying with Administrative Regulation and that departments may lose their privilege of citywide blanket purchase orders until they implement controls within their departments to ensure the Form PA-2610 is completed in a timely manner.

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Responsibility

Purchasing Dept. (cont'd)

Action

- h. Reviews vendor folders for vendors who send invoices late or to the incorrect address.
  - 1. Notifies vendors of their failure to comply with Form PA-2610.
- i. Researches undocumented invoices.
  - 1. Verifies that invoice is not paid on the Accounts Payable document cross-reference screen C7506.
  - 2. Requests vendor to send copy of delivery receipt.
  - 3. If no delivery receipt and #2 copy of Form PA-2610, returns invoice to vendor indicating the City cannot pay until sufficient information to locate the receiver is obtained.
- j. Processes modifications:
  - 1. Requests modifications as early as possible from Buyer.
  - 2. Contacts Buyer after one week's time. If no response, contacts Buyer's supervisor and logs information.
  - 3. If no response, contacts Assistant Purchasing Agent.

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APPENDIX

Forms Involved

Citywide Blanket Purchase Order Form PA-2610  
Purchase Requisition Form PA-2159

Subject Index

Purchasing - Citywide Blanket Purchase Order  
purchasing - Department Blanket Purchase Order  
Emergency - Purchases  
Central Stores - Purchase of non-stock or emergency items

Administering Department

Purchasing Department



Exhibit C

THE CITY OF SAN DIEGO  
M E M O R A N D U M

**DATE:** March 30, 2010  
**TO:** Kyle Elser, Audit Manager  
Tricia Mendenhall, Principal Auditor  
**FROM:** Hildred Pepper, Purchasing & Contracting Director  
**SUBJECT:** Citywide Open Purchase Order Program Audit

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Thank you for presenting you findings and recommendations regarding the above referenced audit report. This presents a unique opportunity to work collaboratively. We look forward to implementing the recommendations.

  
Hildred Pepper, Jr.

Attachment: Response to Citywide Open Purchase Order Program Audit

cc: Wally Hill, Assistant Chief Operating Officer  
Jeff Jungers, Stores Operations Supervisor

**Purchasing & Contracting Department**  
**RESPONSE TO CITYWIDE OPEN PO PROGRAM AUDIT**  
**March 30, 2010**

*Recommendation 1. Incorporate the use of a requisition form similar to a form 2610 in the Departmental Blanket/Open Purchase Order program to reduce the risk of misappropriation.*

Purchasing & Contracting Response

Purchasing & Contracting agrees with the recommendation that a form or process similar to the PA-2610 Form be incorporated as part of the Departmental Blanket/Open Purchase Order program grants the City better budget control. The individual department will be responsible for management and control of the form. Purchasing and Contracting will coordinate with its primary departmental users and the Comptroller's Office to develop the form or process within the next 12 months. Purchasing and Contracting agrees that the use of the City-wide Purchase Order Program is not the most efficient delivery method for providing common city-wide goods and services to City departments. Some of the inefficiencies are present because of necessary internal control safeguards. The use of the Departmental Blanket/open Purchase Order does reduce of the risk of misappropriation in that the requisition will be fully encumbered at the time of receipt by the Purchasing and contracting Department. This methodology does not, however, address the issue of use by unauthorized City employees and the possibility that the Purchas Order could be exceeded and the contractor continues to release materials or provide services at the request of City staff.

A fully funded and approved purchase requisition is required from all City departments in order to receive a Departmental Blanket/Open PO which includes the SAP funds availability approval process. Purchasing & Contracting will work with OneSD to identify a SAP release strategy for Departmental Blanket/Open PO's that will incorporate best business practices and internal controls within City departments.

*Recommendation 2. City Management should institute a process and timeline for the elimination of the Citywide Blanket/Open Purchase Order program. Instead, citywide contracts should continue to be established and departments should procure goods and services using the newly revised Departmental Blanket program or some other method that is more efficient and incorporates effective controls.*

## Purchasing & Contracting Response

Purchasing & Contracting agrees with the recommendation that a more efficient process should be implemented to replace the current Citywide Open Purchase Order program. Purchasing & Contracting will actively pursue implementation of the SAP solution currently not in use. Citywide contracts will continue to be established. P&C will continue to establish Departmental Blanket/Open Purchase Orders. The One SD/SAP option is a best business practice and integrates into the City's existing technology platform.

The following information represents a phased approach for the elimination of the Citywide Open PO program;

### Phase 1 - Implementation of MRO contract – January. 2011

The MRO (Maintenance, Repair and Operations) Supply Program contract is expected to be awarded in April/May, 2010. This citywide contract represents fourteen (14) product categories that are currently supported by fifty-six (56) separate Citywide Open PO's. The MRO Supply contract implementation process will involve business process mapping for multiple City departments with the contract vendor(s). The award of this contract will eliminate the need to renew any of the current fifty-six (56) Citywide Open PO's that support MRO products for FY11. Any department that has either not completed the business process mapping phase for MRO implementation, or believes there is a need to continue to do business with one of the identified fifty-six (56) vendors that supply similar products, will be directed to create their own Departmental Open Purchase Order in the interim. If implemented as scheduled, this process will represent a 33% decrease in the number of the current Citywide Open PO's and approximately 65% of the annual transactions.

### Phase 2 - Identification of Citywide Open PO's that support a small number of City departments – April. 2011

There are currently some established Citywide Open PO's that were set up for the primary use of a single City department or in some cases, a small number of City departments. The reasoning for these Citywide Open PO's was because either the department needed to bill on-going purchases from the same vendor to multiple activities (or specific jobs within their organizational structure), or the department needed to directly bill another City department for provided services.

Prior to SAP, the Departmental Blanket/Open PO was not an efficient method as it required input of a significant number of lines of accounting by specific job order. The



Departmental Blanket/Open PO required multiple Journal Voucher transactions in the financial system to move the expenditures into specific activities or jobs and was an extremely labor intensive process. As an alternative, the Citywide Open PO allowed departments to expense the purchase directly to the desired activity or job. A Department Open PO in SAP allows for expensing a purchase transaction to various account assignments within a Business Center at the time of posting the invoice for payment. This functionality within SAP will eliminate the need for Citywide Open PO's that can now be converted to a Departmental Blanket/Open PO. This process will address approximately thirty (30) current Citywide Open PO's.

Phase 3 - Maximize the use of OneSD, City departments and vendors to identify the most efficient method to procure goods and services for the remaining Citywide Open PO's - July, 2012

The remaining Citywide Open Purchase Orders will require individual review and analysis for the most efficient solution. For instance, the city's office supply firm is used by every City department and division. Purchasing & Contracting will work with City departments and vendors to find the best overall SAP solution.

*Recommendation 3. Modify Administrative Regulation 35.15 to adequately reflect the new policies as a result of the actions taken from Recommendations one and two above. Additionally, the Administrative Regulation should include a requirement for departments to document and retain a reconciliation of the requisition forms, similar to the form 2610, on a quarterly basis.*

Purchasing & Contracting Response

As referenced in the response to Recommendation 1., Purchasing and Contracting agrees that developing a similar form or process to the current PA-2610 Form, to be used for Departmental Blanket/Open PO's, is a solution to strengthening the internal controls for making purchases from Departmental Blanket/Open Purchase Orders. As stated, Purchasing and Contracting will work with Comptroller's Office and OneSD/SAP to identify the best solution within SAP for reducing possible risk associated with releases from Departmental Blanket/Open PO's and once the process is reviewed and agreed upon, will modify Administrative Regulation 35.15 to include the new process and procedures.

*Recommendation 4.* *City Management should analyze the Stores Revolving fund balance of \$1.4 million to determine if this balance represents a surplus. If this analysis results in the determination of a surplus, it should be transferred back to the applicable funds (general, enterprise, etc.) per the annual appropriations ordinance.*

Purchasing & Contracting Response

Central Stores agrees to analyze the Stores Revolving fund balance and transfer any surplus funds back to the appropriate departments however the fund balance was (\$331,544) (post accrual) as of July 1, 2009 (FY10) as verified with the Comptroller's Office. A reasonable reserve is needed to fund the Central Stores inventory purchases as it has to earn its revenues after the commodities are purchased. The formula for determining what is considered a more prudent reserve for the Fund will be developed in conjunction with the Comptroller's Office. The Comptroller's Office and Central Stores will jointly determine the specific methodology for transferring back any surplus to the applicable funds. The formula will be adjusted annually or as needed, depending on the unique needs of the City.

*Recommendation 5.* *Central Stores should conduct an annual analysis to ensure that all surcharges (storerooms, mailrooms, etc.) are set at an appropriate level to only recoup the cost of service. This analysis should also include a procedure to transfer any surplus at fiscal yearend back to the applicable fund(s).*

Purchasing & Contracting Response

We agree with this recommendation. Central Stores monitors revenues to operating expense on-going throughout the fiscal year. As referenced in the report, in FY05 Central Stores, as part of the Purchasing & Contracting BPR, reduced the surcharge rate for all activities (Citywide Open PO Program, Storeroom Operations and Mail Center Operations) from 10% to 5%. We were able to accomplish this by making significant budget reductions, mostly in the Storeroom Operations activity. In fiscal years 2007 and 2008, the surplus amounts represented 4% and 2.4% respectively of total revenues per year. To recoup FY 07's operating expense; Central Stores calculated that a 4.8% surcharge would apply. For FY08, the surcharge was calculated at 4.9%. Based on this analysis, Central Stores would not have reduced the 5% surcharge. FY09's surplus was more significant. Although sales did remain consistent with FY07 and FY08, operating expenses decreased by approximately 14% due to Central Stores' ability to project cost and adjust expenses accordingly. This created a surplus of over \$377,000 and calculates to a

4.2% overall surcharge to recoup operating expense. Central Stores is currently projecting revenues to exceed operating expenses in FY10.

Central Stores will review the current formula for calculating surcharges to equal operating expenses and will be contacting other agencies to review how rates are set. Central Stores will employ best businesses practices to assist in its annual rate analysis. This analysis will include a procedure for transferring surplus revenue back to applicable funds starting FY11.

*Recommendation 6. City Management should ensure that all departments are aware of discounts and have appropriate procedures in place to ensure that all discounts are taken advantage of for timely payment on City purchases in order to reduce costs.*

Purchasing & Contracting Response

We agree with this recommendation not only as it relates to the Citywide Open PO program but for the organization as a whole. Central Stores is not authorized to submit for payment any invoice until a matching requisition document (PA-2610 Form) has been submitted by the customer department. Central Stores will seek improved submittal timeframes from the customer departments. A Department Open PO does reduce a step in the payment process and thus will create a better opportunity for the City to earn vendor payment discounts.